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No. 97-5310

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

DAVID R. BEACH AND LINDA M. BEACH, HIS WIFE,
Petitioners,

v.

OCWEN FEDERAL BANK,
Respondent.

ON WRIT OF CERTIORARI
TO THE SUPREME COURT OF FLORIDA

BRIEF OF DOROTHY BOTELHO, JAMES AND LILLIAN BURNETT, THE NATIONAL ASSOCIATION OF CONSUMER ADVOCATES AND THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AS AMICI CURIAE IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST OF AMICI CURIAE[1]

Dorothy Botelho is a 73 year old widow who has lived in her home in Massachusetts for 44 years. She successfully raised re-

[1] All parties to this case have consented to the filing of this brief. Letters indicating consent have been submitted contemporaneously. This brief has not been approved or financed by any party to this case or their counsel.

scission under the Truth in Lending Act in the bankruptcy process as a recoupment to a proof of claim by Citicorp Mortgage Co.[2] On appeal to the Court of Appeals for the First Circuit, Citicorp has acknowledged that it failed to provide Ms. Botelho with required notice of her right to cancel and has defended the case solely on the ground that the time limit on rescission in the statute makes recoupment unavailable. The Court of Appeals has stayed Citicorp's appeal pending the outcome of this matter.

James and Lillian Burnett are 83 and 78 years old, respectively. They have owned their home in Brooklyn, N.Y., for more than 35 years. They have raised rescission under the Truth in Lending Act as a recoupment defense to a foreclosure action brought by Delta Funding Corporation. Delta made a mortgage loan to the Burnetts in 1991 through a loan broker based in Brooklyn. The loan was at a disclosed annual percentage rate (APR) of 15.31%. The lender failed to accurately disclose additional finance charges of $14,638.60 which were held back from the loan proceeds. The Burnetts contend that if their Truth-in-Lending disclosures had been accurate, the APR would have been disclosed at 36.43%. Their case is pending for trial in the Supreme Court of New York.

The National Association of Consumer Advocates (NACA) is a non-profit corporation. Its membership comprises attorneys from the private and public sector and legal services, law professors, and law students. All NACA members principally devote their legal practice or teaching efforts to the protection and representation of consumers. NACA's mission is to promote justice for all consumers. To that end, it maintains a forum for information sharing among consumer advocates across the country and serves as a voice for its members as well as consumers in the ongoing struggle to curb unfair and abusive business practices. Its specific areas of concern include abusive practices by financial institutions in the

[2] *In re Botelho*, 195 B.R. 558, 567 (Bankr. D. Mass. 1996) *aff'd*, C.A. No. 96-12279 (D. Mass., March 7, 1997) *appeal pending* No. 97-1535 (1st Cir.).

extension of credit and the collection of debts and, in particular, abuses in the area of home equity fraud and equity skimming.

The National Association of Consumer Bankruptcy Attorneys (NACBA) is a non-profit organization of more than 900 consumer bankruptcy attorneys nationwide. Member attorneys and their law firms represent debtors in an estimated 150,000 bankruptcy cases filed each year. NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues which can not adequately be addressed by individual member attorneys. It has joined this brief because the bankruptcy forum is frequently where consumer recoupment claims are raised.[3]

Amici believe that important rights are vindicated when consumer claims are raised by recoupment to claims by their creditors. In most cases, consumers do not fully evaluate their defenses to a contract until they are faced with a collection action — often after a relevant limitations period has expired.

Consumers should have the same right as businesses to raise recoupment in contract cases. The underlying principle that it is fundamentally unfair to allow one party to a lawsuit to proceed while denying the defenses of the other on procedural grounds is equally applicable in consumer cases.

SUMMARY OF ARGUMENT

The Florida Supreme Court erred in holding that a Truth in Lending Act (TILA) rescission claim could not be asserted defensively in recoupment. The language of the statute, as amended in 1995, makes clear that Congress intended to allow rescission for violations of TILA by recoupment, consistent with state law. 15

[3] *E.g., In re Fidler*, 211 B.R. 411 (Bankr. D. Mass. 1997); *In re Shaw*, 178 B.R. 380 (Bankr. D.N.J. 1994).

U.S.C. § 1635(i)(3). Inexplicably, the *Beach* court's holding ignores the relevant statutory provision, concluding without explanation that it does not apply to the case at hand.

The *Beach* court's reasoning conflicts with decisions from this Court expressly allowing the defensive use of time-barred claims in recoupment. As a matter of federal law, recoupment claims are not subject to statutes of limitation, as long as the main action is timely, but such claims are limited to the extent of the plaintiff's claim. Time-barred claims can be used to offset amounts allegedly due, but cannot result in an affirmative recovery. As consistently held by this Court, recoupment applies to statutory claims as well as common law claims, absent clear Congressional intent to prohibit recoupment.

Even prior to the 1995 statutory amendments to TILA which expressly recognize that recoupment rights apply to rescission claims, courts in several states had held that rescission claims based on violations of the federal Truth in Lending Act could be raised by way of recoupment. In 1995, Congress rejected a proposed amendment which would have overruled these cases and instead adopted a provision explicitly preserving rescission in recoupment consistent with state law, signaling its approval of these holdings. 15 U.S.C. § 1635(i)(3).

Notwithstanding that the decision of the Florida Supreme Court is couched in terms of Florida procedural rules, that Court has applied those rules in a manner designed to undermine an important federal right. The Court's blanket rule to deny defensive use of rescission to consumers by way of recoupment impermissibly usurps the judgment of Congress. This conclusion is particularly true, where, as here, the Court's bases for denying rescission are rooted, at bottom, on an erroneous evaluation of the federal law. The opinion of the Florida Supreme Court acknowledges that state law allows recoupment of rescission claims, but incorrectly and impermissibly interprets federal law to exempt TILA rescission claims.

Finally, Congressional language which preserves a defense for homeowners seeking to protect their shelter has a legitimate policy basis which is at least as weighty as the policy concerns raised by the mortgage lending industry. To the extent that the industry can present evidence that recoupment defenses based on consumer rescission rights undermine its business, it is fully capable of presenting that proof to Congress.

Most recently, however, by enacting 15 U.S.C. § 1635(i)(3) in 1995, Congress rejected the position espoused by the respondents and their amici in favor of setting public policy to preserve a consumer's right to raise TILA rescission as a recoupment defense in foreclosure. Sensibly, this helps elderly homeowners and families protect their shelter.

ARGUMENT

I. TILA MUST BE CONSTRUED IN A MANNER CONSISTENT WITH THE PURPOSE OF PROTECTING BORROWERS FROM THE UNINFORMED USE OF CREDIT.

The Truth in Lending Act was enacted in 1968 to regulate the disclosure of the terms of consumer credit transactions in order to "aid the unsophisticated consumer so that he would not be easily misled as to the total costs of financing." *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 363-69 (1973). By requiring a set of uniform disclosures of credit terms, TIIA allows consumers to compare different financing options and their costs. 15 U.S.C. §1601(a); *Ford Motor Credit* v. *Milhollin*, 444 U.S. 555, 559 (1980). Prior to its enactment, consumers had no easy way to compare various credit options because creditors were not required to use a uniform method of calculating interest. *Mourning, supra*. Because TILA is a remedial statute, courts have long held that

TILA is to be liberally construed in favor of consumers. *Rodash* v. *AIB Mortgage Co.*, 16 F.3d 1142 (11th Cir. 1994).[4]

To encourage compliance and ensure protection for all consumers, TILA violations are measured by a strict liability standard — "strict liability in the sense that absolute compliance is required and even technical violations will form the basis for liability." *Shepeard* v. *Quality Siding & Window Factory, Inc.*, 730 F. Supp. 1295, 1299 (D. Del. 1990). Therefore, "technical or minor violations of TILA, or Reg. Z, as well as major violations impose liability on the creditor and entitle the borrower to rescind [the loan]." *Jackson* v. *Grant*, 890 F.2d 118, 120 (9th Cir. 1989); *Semar* v. *Platte Valley Fed. S & L Assoc.*, 791 F.2d 699, 704 (9th Cir. 1986); *Mars* v. *Spartanburg Chrysler Plymouth, Inc.*, 713 F.2d 65, 67 (4th Cir. 1983).

TILA subjects violators to claims for statutory damages, actual damages, and attorneys fees for disclosure violations. 15 U.S.C. §1640(a). In addition, where a non-purchase money security interest is taken in the borrower's home, the borrower has the unqualified right to "rescind," or cancel the loan, for three days after the transaction, or longer if the required disclosures are not made. 15 U.S.C. § 1635.

At the time of consummation of a rescindable credit transaction, the borrower must be given a disclosure statement containing all material information correctly disclosed. 15 U.S.C. § 1638. The borrower must also receive two copies of the notice of right to rescind, which clearly and conspicuously explains the borrower's rescission rights and how to rescind. 12 C.F.R. § 226.23(b). The rescission right is absolute for three business days following the latest of: the consummation of the transaction, the delivery of the

[4] *See also Fairley* v. *Turan-Foley Imports, Inc.*, 65 F.3d 475 (5th Cir. 1995); *Semar* v. *Platte Valley Fed. Sav. & Loan Ass'n.*, 791 F.2d 699 (9th Cir. 1986); *Bizier* v. *Globe Financial Services, Inc.*, 654 F.2d 1 (1st Cir. 1981); *Thomka* v. *A.Z. Chevrolet, Inc.*, 619 F.2d 246, 248 (3d Cir. 1980); *N.C. Freed Co. Inc.* v. *Governors of Fed. Reserve Sys.*, 473 F.2d 1210, 1214 (2d Cir.), *cert. denied*, 414 U.S. 827 (1973).

right to rescind notice, or the delivery of all material disclosures. 15 U.S.C. §1635(a).

If the material disclosures or the notice of right to cancel are not provided as required, the borrower's affirmative right of rescission continues for three years from the date of consummation or until the sale of the property, whichever occurs first. 15 U.S.C. § 1635(f). The remedy of rescission is designed to be self-enforcing. If borrowers are not given accurate information when they enter into the loan, rescission restores the parties to their positions prior to the transaction. *Williams* v. *Homestake Mortgage Co.*, 968 F.2d 1137 (11th Cir. 1992).

The rescission provision was enacted "to give the consumer the opportunity to reconsider any transaction which would have the serious consequence of encumbering the title to his home." S.Rep. No. 368, 96th Cong., 2d Sess. 28 *reprinted in* 1980 U.S.C.C.A.N. 236, 264. Without the availability of the extended right to rescind, lenders can defeat the consumer's cancellation rights by failing to provide information about rescission at all or by providing misleading or inaccurate information. *See Rodash* v. *AIB Mortgage Co.*, 16 F.3d 1142 (11th Cir. 1994). To assure compliance with the Act, Congress has made the rescission right available even when the misdisclosure did not affect the consumer's decision to enter the transaction. *Rodash, supra; Mayo* v. *Key Financial Services, Inc.*, 424 Mass. 862, 678 N.E.2d 1311, 1313 (1997).

As will be discussed more fully below, TILA was recently amended to expressly provide that the time limitation contained in the rescission section does not in any way affect a borrower's right to raise rescission by recoupment beyond the limitations period, consistent with state law. 15 U.S.C. 1635(i)(3). That amendment was made as part of a significant set of changes to the rescission provisions in order to protect the vitality of prior case law allowing rescission to be raised by recoupment after the statutory time lim-

its. It also safeguards the right in its most important context — protecting a family's home in foreclosure.[5]

Moreover, the amendment applies retroactively, "to all consumer credit transactions in existence or consummated on or after the date of enactment" of the amendments. 15 U.S.C. § 1635(i)(4). The amendment therefore applies to the *Beach* case.

II. The Florida Supreme Court Erred in Deciding That Rescission in Recoupment Is Barred by § 1635. The Language of the Statute as Amended and Relevant Case Law Regarding Recoupment Make Clear That Recoupment Is Available.

A. *Recoupment Is a common Law Doctrine of Long Standing Which Allows the Defensive Assertion of Time-barred Claims, But Limits Such Claims to the Extent of the Plaintiff's Claim. The Defense Applies to This Case.*

Recoupment is a well-established device of common law origin that enables a defendant to raise a counterclaim which is otherwise time barred against asserted liability arising out of the transaction forming the basis for the suit, but only to the extent of the asserted liability. *Reiter* v. *Cooper*, 507 U.S. 258, 264 (1993). Recoupment survives as long as the cause of action on the note exists. *Dawe* v. *Merchants Mortg. and Trust Corp.*, 683 P.2d 796, 799 (Colo. 1984); *In re Shaw*, 178 B.R. 380, 386 (Bankr. D.N.J. 1994). Recoupment claims at common law are limited to the extent of the plaintiff's claim and can never result in an affirmative recovery from the defendant.

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[5] The "bill protects the most vulnerable consumers. It provides consumers with Truth in Lending protections when faced with foreclosure. This bill will help many elderly keep their homes." Statement of Sen. Sarbanes, 141 Cong. Rec. S14567 (Sept. 28, 1995).

The availability of recoupment in contract-based cases has been repeatedly recognized and endorsed by this Court. *Bull* v. *United States*, 295 U.S. 247, 262 (1935):

> [R]ecoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded. Such a defense is never barred by the statute of limitations so long as the main action itself is timely.

See also, e.g., United States v. *Dalm*, 494 U.S. 596, 599 *reh'g. denied* 495 U.S. 941 (1990); *Burnett* v. *New York Cent. R.R.*, 380 U.S. 424 (1965).

In *United States* v. *Western Pacific Railroad Co.*, 352 U.S. 59, 72, (1956) the Court stated:

> We think it would be incongruous to hold that once a lawsuit is properly before the court, decision must be made without consideration of all the issues in the case and without the benefit of all the applicable law. If [the] litigation is not stale, then no issue in it can be deemed stale. The reason for this rule is that the purposes of statutes of limitations are not served by allowing one party to enforce claims while denying the other's related defenses.

See Burnett v. *New York Cent. R.R.*, 380 U.S. 424 (1965).

Although most of these cases have arisen in the context of contractual relations among businesses, there is no basis to distinguish defensive use of consumer claims. In fact, where the issue in-

volved is protection of the family home, there is special importance attached to preserving available defenses.[6]

Recoupment has been applied to claims created entirely by statute. For example, in *Reiter* v. *Cooper, supra*, the claim at issue arose under the Interstate Commerce Act (ICA). This Court found that claims for unreasonably high shipping tariffs under the ICA were subject to recoupment after the two year limitation period contained in the statute expired. *Id.* at 614. The Court quoted from an earlier case adopting the same conclusion: "Only the clearest congressional language could force us to a result which would allow a carrier to recover unreasonable charges merely by waiting two years before filing suit." *Id.* at 616, *quoting, United States v. Western Pacific R. Co.*, 352 U.S. 59, 71, 1 L.Ed. 2d 126, 77 S.Ct. 161 (1956). *See also Burnett* v. *New York Cent. R. Co., supra* 380 U.S. at n.2 ("the fact that the right and limitation are written into the same statute does not indicate a legislative intent as to whether or when the statute of limitations should be tolled."). The *Beach* court's reasoning is in direct conflict with these holdings.

The Florida Court's conclusion that § 1635 is a statute of repose rests to a large extent on the fact that the right of rescission is both created and limited by TILA. The cases cited above make clear that this factor is not dispositive, and that it is the *language* of the statute which must ultimately control.

The Florida Court cites two federal cases, *Simon* v. *United States*, 244 F.2d 703 (5th Cir. 1957), and *Maahs* v. *United States*, 840 F.2d 863 (11th Cir. 1988), in support of its reasoning that when the right and remedy are created by the same statute, the limitation on the remedy is treated as absolute. *Beach*, 692 So. at 152-153. Both of these cases, however, arose under the Federal Tort Claims Act (FTCA), which waives sovereign immunity for

[6] This principle was recognized by Congress when it explicitly referred to rescission rights in recoupment in a section labeled "rescission rights in foreclosure". Pub. L. No. 104-29, § 8 (Sept. 30, 1995) (15 U.S.C. § 1635(i)).

certain tort claims and creates a cause of action against the United States, which would otherwise be immune from suit. The FTCA provides that a "tort claim against the United States shall be forever barred unless it is presented in writing to the appropriate Federal agency within two years after such claim accrues. . . " 28 U.S.C. § 2401(b). The FTCA does not contain express language leaving the question of recoupment to state law.[7] Moreover, any waiver of sovereign immunity must be read narrowly, *United States* v. *Kubrick*, 444 U.S. 111 (1979), unlike TILA, which has been liberally construed to protect consumers.[8]

Recoupment does not create an exception to the statute of limitations or extend limitations indefinitely. Recoupment claims are limited to the extent of a plaintiff's timely claim and are permitted only when the opposing claim arises out of the same transaction or occurrence. Therefore, lenders never have to pay out money following a successful rescission. The borrower can only defend against the lender's claim by asserting a claim in recoupment.

B. *TILA Rescission Claims Are Available Under the Recoupment Doctrine.*

Prior to 1995, the courts which considered this question were unanimous in holding that borrowers who were defending against a foreclosure could raise a rescission claim as a recoupment more than three years after the date of the loan, because the three year limitation in § 1635(f) governed affirmative claims only. *Dawe* v. *Merchants Mtg. & Trust Co.*, 683 P.2d 796 (Colo. 1984); *Westbank* v. *Maurer*, 276 Ill. App. 3d 553, 658 N.E.2d 1381 (1995)

[7] TILA includes such a provision in the form of 15 U.S.C. § 1635(i)(3).

[8] *See* note 4, *supra*, and accompanying text.

app. denied 166 Ill. 2d 555, 664 N.E.2d 648 (1996); *FDIC* v. *Ablin*, 117 Ill. App. 3d 390, 532 N.E.2d 379 (1988); *Community Nat'l. Bank & Trust* v. *McClammy*, 138 A.D. 2d 339, 525 N.Y.S.2d 629 (1988); *In re Shaw*, 178 B.R. 380 (Bankr. D. N.J. 1994).[9] These courts held that rescission claims arise out of the loan transaction on which the lender is seeking to foreclose and, therefore, recoupment applies. This body of law was preserved in 1995 when Congress enacted 15 U.S.C. § 1635(i)(3) protecting recoupment claims.[10]

Only the *Beach* court has barred a rescission claim raised in recoupment. Despite the *Beach* court's assertion that there is a split of authority on this issue, no other court which has squarely addressed this issue has refused to allow rescission by recoupment.

C. *Any Doubt on Whether the Statutory Time Limit Acts as an Absolute Bar to Recoupment Claims Has Been Resolved By Recent Amendments to TILA.*

In 1995, Congress confirmed that the overwhelming majority of courts were correct in holding that rescission claims are subject to recoupment rights if recoupment is available under state law. In the 1995 amendments to TILA, Congress added a new subsection to section 1635 titled "*Rescission Rights in Foreclosure.*" 15

[9] Cases other than *Beach* decided since the 1995 amendments have also been unanimous in allowing consumers to rescind by way of recoupment. *In re Botelho*, 195 B.R. 558, 567 (Bankr. D. Mass. 1996) *aff'd.* C.A. No. 96-12279 (D. Mass., March 7, 1997) *appeal pending* No. 97-1535 (1st Cir.); *In re Fidler*, 210 B.R. 411 (Bankr. D. Mass. 1997); *Transamerica Financial Services Inc.* v. *Abendroth*, slip opinion, CFN C8-96-4307 at pp. 7-8 (Minn. D.Ct., 10th Jud. Dist., April 17, 1997). Unlike *Beach*, these cases have considered the 1995 addition of 15 U.S.C. § 1635(i)(3) to the statute. The *Botelho* appeal had been stayed pending the outcome of the case before this court.

[10] Congress must be understood to have enacted this provision with an awareness of the existing case law. *See e.g., Dewsnup* v. *Timm*, 502 U.S. 410 (1992).

U.S.C. § 1635(i). This new section provided two additional grounds for rescission for borrowers facing foreclosure.

Though the new section states that the added rescission rights in foreclosure are subject to the (three year) time period in subsection (f), it also contains the following additional provision:

> *Right of recoupment under state law*: Nothing in this subsection affects a consumer's right of rescission in recoupment under State law.

15 U.S.C. § 1635(i)(3). This language can have only one meaning: rescission is available by recoupment after the expiration of the time limit consistent with state law.[11] Congress also specifically provided that "This subsection shall apply to all consumer credit transactions in existence or consummated on or after September 30, 1995." 15 U.S.C. § 1635(i)(4). Consequently, the new provision applies both prospectively and retroactively. The new provision applies to the *Beach* mortgage loan because it was in existence on the effective date of the amendments.

In light of these statutory pronouncements, there can be no room for argument that § 1635(f) is a statute of repose.[12] If Congress intended section 1635(f) to be an absolute bar prohibiting recoupment, there would be no reason to add the new language which leaves the availability of the consumer's right of recoupment to state law, and makes the subsection applicable to all existing consumer credit transactions.

[11] This provision makes the treatment of rescission rights by recoupment consistent with treatment of other claims under TILA. *See* 15 U.S.C. § 1640(e).

[12] The language of the statute is unambiguous. The Court must give meaning to the plain language of the statute. *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989); *U.S.* v. *Turkette*, 452 U.S. 576 (1981).

Congress' intent to allow recoupment is apparent from the language of the statute. Even if it were not, only the clearest Congressional language will support a holding that a claim under a federal statute is not subject to recoupment. *Reiter v. Cooper*, 507 U.S. 258 (1993); *United States* v. *Western Pacific Railroad Co.*, 352 U.S. 59, 71 (1956).

Because *Beach* concludes that *Congress* sought to prohibit recoupment in enacting § 1635(f), it must be overturned. As the above analysis makes clear, Congress has actually preserved recoupment in accordance with state law. The *Beach* court did not deny recoupment because of a state law limitation on the remedy, but rather because it interpreted the statute to preclude recoupment. While Florida state law may impose limits on the right of recoupment generally, as discussed in more detail in part III of this brief, Florida may not interpret federal law in way which conflicts with clear Congressional language.

1. Language adopting the *Beach* Court's interpretation was proposed in an earlier version of the amendments to TILA and was rejected by Congress.

On March 9, 1995, Representative Bill McCollum and others introduced a bill, H.R. 1184, 104th Cong., 1st Sess. (1995), to amend the Truth in Lending Act.[13] The bill included the following provision:

[13] Three other bills were introduced during the same period with virtually identical this language. H.R. 1858, § 111, 104th Cong., 1st Sess. (1995) (Banking Committee Chair Leach), H.R. 1362, § 111, 104th Cong., 1st Sess. (1995) (Rep. Bereuter); and S. 650, § 117, 104th Cong. 1st Sess. (1995) (Senators Shelby and Mack). A more complete description of the legislative history is included in the brief of the amicus curiae, American Association of Retired Persons.

Sec. 7. Limitation on Rescission period.

Section 125(f) [15 U.S.C. § 1635(f)] of the Truth in Lending Act (15 U.S.C. § 1635(f)) is amended by adding at the end the following sentences: "The expiration of the right of rescission pursuant to this subsection *shall be absolute and no consumer may assert rescission, affirmatively or as a defense, in any action in any State or Federal court after the earlier of the end of the 3-year period beginning on the date of the consummation of the transaction* or the sale of the property securing the loan or other extension of credit, except as otherwise provided in the preceding sentence. *This section shall supersede any State law which is inconsistent with any provision of this subsection.*"

H.R. 1184, 1995 CQ US HR 1184, 104th Cong. 1st Sess. (1995) (emphasis added).

The meaning of this proposed language could not be more clear. This provision would have, without a doubt, enacted the judgment of the *Beach* court and eliminated the right of rescission by recoupment after three years. This provision is the language that the mortgage bankers urged Congress to adopt. Congress declined. Not only was the proposed "limitation" language excised from the final bill, it was replaced with the current § 1635(i)(3), which *preserved* rather than preempted a borrowers state law right to assert claims in recoupment.

Congress' rejection of this language cannot be disregarded. *See, e.g., Bennett* v. *Kentucky Dept. of Education*, 470 U.S. 656, 665 at n.3 (1985) (rejection of an amendment by a later Congress has persuasive value when construing a statute); *New York Telephone Co.* v. *New York State Dept. of Labor*, 440 U.S. 519, 544 at n.44 (1979)

(rejection of a position by Congress considered in construing a statute). Here Congress not only repudiated the proposed amendment, it actually enacted language to the opposite effect.[14]

2. The legislative history of § 1640(e) does not support the *Beach* Court's holding.

The Florida Court placed substantial reliance on the fact that in 1980 Congress added language allowing recoupment to § 1640(e), the general TILA limitations provision, but did not at that time add similar language to § 1635. *Beach*, 692 So. 2d at 152. Again, the court overlooks the fact that Congress did add recoupment language in 1995.

Section 1640(e) provides that actions based on TILA disclosure violations must be brought within one year of the violation. 15 U.S.C. 1640(e). This section expressly provides that this limitation "does not bar a person from asserting a violation of this subchapter in an action to collect the debt which was brought more than one year from the date of the occurrence of the violation as a matter of defense by recoupment or set-off in such action, except as otherwise provided by state law." This provision was added in 1980 to resolve a conflict among the courts as to whether these claims could be raised in recoupment. *See, e.g., In re Werts*, 48 B.R. 980 (E.D.Pa. 1985) (allowing recoupment); *Ballew* v. *Associates Fin. Services*, 450 F.Supp. 253 (D.Neb. 1976) (same); *Hewlett* v. *John*

[14] The holding of *Dawe* and other similar cases are also reinforced by this Congressional action. When a particular statutory interpretation by the courts has been explicitly brought to the attention of Congress, as here, and where Congress has not sought to alter that interpretation despite amending the statute in other respects, then "presumably the legislative intent has been correctly discerned." *See North Haven Board of Education* v. *Bell*, 456 U.S. 512, 535, 102 S. Ct. 1912, 72 L.Ed. 2d 299 (1982) *quoting Apex Hosiery Co.* v. *Leader*, 310 U.S. 469 (1940).

Blue, 344 So. 2d. 505 (Ala. Civ. App. 1976) *cert. denied* 344 So. 2d 509 (Ala. 1977) (holding that recoupment not available because TILA claim was not related to the subject matter of plaintiffs suit); *Basham* v. *Finance America Corp.*, 583 F.2d 918 (7th Cir. 1978) *cert. denied* 444 U.S. 825 (1979).

At the time the recoupment language was added to § 1640(e), there was no similar conflict among the courts with respect to rescission claims. The first reported decision on this issue, *Dawe, supra*, was issued in 1984. Thus, there was no reason in 1980 for Congress to address the rescission question at all.

In 1995, on the other hand, saving language was necessary. Absent the addition of 15 U.S.C. § 1635(i)(3), lenders could have argued that the reference in subsection (i)(1) to the time limitation in subsection (f) overruled case law, such as *Dawe*, about use of recoupment under state law in the context of foreclosure.

III. The Decision Below Conflicts With Federal Law

The conclusion that TILA right of rescission may be revived as a defense in recoupment does not fully resolve this case. By its terms, 15 U.S.C. § 1635(i)(3) conditions the availability of recoupment on state law. This condition expresses the same contingency as the parallel TILA provision under § 1640(e) applicable to recoupment generally ("except as otherwise provided by State law") and conforms to the teaching of this Court that enforcement of federal rights is subject to state "rules of procedure governing litigation in their own courts." *Felder* v. *Casey*, 487 U.S. 131, 138 (1988).

Application of state law is nevertheless subject to two relevant and well established principles of federalism. First, state courts are obligated to interpret and apply substantive federal law in accordance with federal standards. *Maine* v. *Thiboutot*, 448 U.S. 1, 10-11 (1980); *Sims* v. *Georgia*, 385 U.S. 538, 544 (1967); *Testa* v.

Katt, 330 U.S. 386, 390-92 (1947). The Florida Supreme Court, by its holding that the remedy of rescission is never available in recoupment, violates this fundamental principle. Is so holding, the state court has substituted its judgment for that of Congress.

Second, the Constitution prohibits states from adopting or applying their rules of practice in any manner that discriminates against a federal claim or that prevents effective enforcement of federal law:

> Under the Supremacy Clause of the Federal Constitution, the relative importance to the State of its own law is not material when there is a conflict with a valid federal law, for any state law, however clearly within a State's acknowledged power, which interferes with or is contrary to federal law, must yield.

Felder, 487 U.S. at 138 (quotations omitted). The "federal right cannot be defeated by the forms of local practice," nor can state rules "stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Id.* In addition, state rules may not be "fixed in a way that would discriminate against federal claims, or be inconsistent with federal law in any respect." *Wilson* v. *Garcia*, 471 U.S. 261, 279 (1985). *Accord Reconstruction Finance Corp.* v. *Beaver County*, 328 U.S. 204, 210 (1946). Therefore, review of a decision clothed in terms of state law necessarily requires further scrutiny in order to determine the true basis for its disposition:

> [T]his Court has an independent obligation to ascertain whether a judgment defeating enforcement of federal rights rests upon a valid nonfederal ground and whether that ground finds fair and substantial support in state law.

Howlett v. *Rose*, 496 U.S. 356, 366, n. 14 (1990) (quotation omitted). With particular relevance to the decision below, this examination must reveal whether a state ruling declining to enforce a federal right rests on "conceptions of impolicy or want of wisdom on the part of Congress in having called into play its lawful powers." *Testa*, 330 U.S. at 393 (quotation omitted).

A. *The Decision Below Is Based On an Erroneous Construction of Section 1635.*

These principles of faithful application of federal law and nondiscriminatory local practice provide the standards for examining the propriety of the holding below that TILA rescission is not permitted by recoupment in the Florida courts. If the rules of procedure in Florida or any other State do not recognize the right of recoupment as a matter of uniform State practice, the State may deny in its courts enforcement of the right of rescission by recoupment under TILA in a foreclosure action brought more than three years after closing. Conversely, if a state otherwise permits recoupment with regard to State claims, it is barred by the Supremacy Clause from discriminating against the federal right and from denying the defense to litigants in its courts.

The Florida Supreme Court appropriately viewed federal law as the initial source of its legal analysis. However, the Court's conclusion that § 1635 does not permit revival of rescission rights after three years is patently in error. Its belief that "Congress' intent regarding rights of rescission under TILA. . . . support[s] the majority opinion" of the intermediate Florida appellate court (692 So.2d at 149) is incorrect, as addressed in Section II, *supra*. Its refusal to

consider the 1995 adoption of 1635(i)(3) (*Beach*, at 149, n. 6) and its holding that § 1635(f) "unambiguously expresses Congress' intent to extinguish the statutory right of rescission three years after the transaction's closing" (*Beach*, at 152) incorrectly applies federal law. Its conclusion that "Florida law and federal law appear consistent" in refusing to permit recoupment, *Beach*, at 153, leaves no doubt but that the Court's holding is based on an erroneous application of federal law. Even its assessment of State public policy, discussed below, hinges on its belief that "Congress has not chosen to extend" the right of rescission past the initial three years and that it was at liberty to substitute its judgment as to the wisdom of the remedy for that of Congress. *Beach*, at 148, n. 4, and 151.

As acknowledged by the court below, "[i]n Florida, it is well established that the defense of recoupment may be asserted defensively where the underlying claim is barred by the statute of limitations." *Beach*, 692 So.2d at 150 (quotation omitted). on its face, therefore, the Florida Court's holding is constitutionally suspect, since it is at odds with this "neutral state rule regarding the administration of the state courts." *Johnson* v. *Fankell*, ___ U.S. ___, ___, 117 S.Ct. 1800, 1805 (1997). Upon inspection, it cannot be reconciled with the supremacy of federal law.

The Florida Court attempted to distinguish the unbroken line of Florida cases permitting recoupment on the grounds that "[n]one of the cases (permitting recoupment] addressed a TILA-type statute where the act created the right and provided a remedy." *Beach*, 692 So.2d at 150. This distinction is a self-fulfilling, circular formulation that merely begs the federal question addressed above in Section II. If federal law does not allow TILA rescission to be revived in recoupment, whether as a result of this distinction or for any other reason, the defense admittedly is barred, but only as a matter of federal law. If, however, federal law permits its revival after three years, the distinction which the Court below found dispositive is simply a fundamental misapplication of federal law. In either event, the issue is one of the intent of the federal statute and

therefore a matter of federal law, not the neutral, nondiscriminatory enforcement of State rules allowed by the Supremacy Clause.

The three prior Florida Supreme Court decisions which have recognized recoupment defenses confirm the uniform rule of State practice that must be applied to this federal claim. *Allie* v. *Ionata*, 503 So.2d 1237 (Fla. 1987); *Rybovich Boat Works* v. *Atkins*, 585 So. 2d 270 (Fla. 1991); *Beekner* v. *L.P. Kaufman*, 198 So. 794 (Fla. 1940). Each reaffirms that Florida permits recoupment as a defensive doctrine, including in rescission (*Allie* and *Rybovich*).

No State law principle exists to distinguish these prior cases, other than the right/remedy differentiation which the Court applied. However, that analysis only demonstrates that the court was limiting substantive federal law by use of a conflicting State rule of statutory construction. *Reconstruction Finance Corp.*, 328 U.S. at 208. *See, e.g., Howlett* v. *Rose*, 496 U.S. at 366 ("The adequacy of the state-law ground to support a judgment precluding litigation of the federal claim is itself a federal question . . .").

B. *Florida's Conclusion That Recoupment Based on Truth in Lending violations Is Inconsistent With Public Policy Is Contrary to Federal Law.*

To the extent that the Court below ruled on the basis of state law, it did so as a matter of state "public policy." *Beach*, 692 So. 2d at 151. The Court embraced the view of "the district court that the real danger is that borrowers could take advantage of the remedy throughout the entire life of the secured transaction . . . *Id.* Furthermore, it viewed TILA rescission as "a penalty provision to the creditor, not a remedy required in equity and good conscience beyond the statutory period of three years." *Beach*, 692 So.2d at 153.

These assessments each conflict with federal law. The "danger" that borrowers might assert a recoupment defense beyond the initial three year period is no danger at all but is the right guaranteed by federal law implementing the very policy decision that Congress made in adopting § 1635(i)(3).

Notwithstanding § 1635(i)(3), that "danger" is also the rule of law enunciated by this Court in *Reiter* v. *Cooper, supra*, that, absent "the clearest congressional language," an expired federal remedy may be revived defensively in recoupment. 507 U.S. at 264. Such a repudiation by a State court of federal law under the guise of a "danger" to local public policy is fundamentally in error. *Testa* v. *Katt*, 330 U.S. at 392-93.

Similarly, the pejorative characterization of the defensive use of TILA rescission as a "penalty," contrary to "equity and good conscience," is the precise grounds articulated by the State court and rejected by this Court in *Testa* v. *Katt, supra*, as an impermissible infringement on the authority of Congress to set national public policy. 330 U.S. at 392 ("[T]he fact that Rhode Island has an established policy against enforcement of statutes of other states and the United States which it deems penal, cannot be accepted . . .") This "penalty" exists as a matter of federal law.[15] It is a right conferred by Congress on every citizen, limited only by the non-discriminatory, neutral rules of State practice. Congress adopted this portion of TILA to protect ordinary homeowners from predatory lending practices as well as to insure that honest and ethical creditors who comply with the law are not competitively disadvantaged. 109 Cong. Rec. 2029-30 (1963) (remarks of Sen. Paul Douglas).

[15] If the right of rescission were a penalty, it could not be imposed against any governmental actor, in accordance with 15 U.S.C. § 1612(b) ("No civil or criminal penalty provided under this subchapter for any violation thereof may be imposed upon the United States, or any department or agency thereof, or upon any State or political subdivision thereof, or any agency of any State or political subdivision thereof.") However, the federal courts have held that TILA rescission is not a penalty barred by this provision. *FDIC* v. *Hughes Development Co.*, 684 F.Supp. 616, 621-23 (D.Minn. 1988); *FDIC* v. *Monterrey, Inc.*, 847 F. Supp. 997, 1004, n.9 (D. P.R. 1994).

The Florida Court's rejection of the federal law here, couched in terms of State law, warrants the same response as this Court articulated in *Howlett* v. *Rose, supra*:

> These reasons . . . are not the kind of neutral policy that could be a "valid excuse" for the state court's refusal to entertain federal actions. To the extent that the Florida rule is based upon the judgment that parties who are otherwise subject to the jurisdiction of the court should not be held liable for activity that would not subject them to liability under state law, we understand that to be only another way of saying that the court disagrees with the content of federal law.

496 U.S. at 379.

The Florida Court attempted to disguise its rejection of Congressionally established policy as one which is based on the equities of the rescission remedy. *Beach*, 692 So. 2d at 150. Congress, however, has already made that determination in favor of allowing homeowners the right to raise rescission by recoupment.

Moreover, Congress and the Federal Reserve Board have limited consideration of the equities to expressly delineated elements of a rescission claim. The elements on which equities can be considered concern the time and procedures for implementing the rescission remedy — not the existence, scope or application of the rescission right itself.

The Truth in Lending Act is, for the most part, designed as a strict liability statute. outcomes do not depend on whether the violation caused harm to the defendant and Congress has required re-

lief for some violations which courts have described as "technical".[16]

However, Congress has allowed trial courts some latitude to modify statutory rescission remedies, but not liability, by exercise of equitable discretion. 15 U.S.C. § 1635(b). The Federal Reserve Board, through its adoption of Regulation Z and its Official Staff Commentary, has given effect to this provision, explicitly stating that such modification may occur "when the equities dictate." 12 C.F.R. Part 226, Supp. I, § 226.23, comment 23(d)(4)-1, p. 402 (1997).[17] *See* 12 C.F.R. § 226.23(d)(4) (1997).

Under the statute and regulations, a court may not refuse to grant rescission for violations which Congress has delineated and it may not prevent the resulting voiding of the underlying mortgage or the cancellation of liability for finance charge. A court has discretion to modify only the date of performance by the lender and the consumer's obligation to tender. 12 C.F.R. § 226.23(d)(4).[18] A court cannot appropriately go beyond this mandate, as the Florida Court has done, and make its own independent judgment of the equities underlying exercise of the rescission remedy itself.

If the Court had applied a neutral rule that recoupment is subject to equities, it would have had to evaluate the *Beaches*' circumstances and deny rescission only if it found, for example, that they engaged in bad faith in a strategic default. It did not do that. It did not consider any case by case concern and instead held that TILA

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[16] *See* Part I, *supra*.

[17] Federal Reserve Board staff commentary to the regulation is entitled to great deference. *Ford Motor Credit* v. *Milhollin*, 444 U.S. 555, 559 (1980).

[18] Courts acting under this grant of equitable power recognize that their discretion is considerable and have shown no reluctance to use it when deemed appropriate. Indeed, the Eleventh Circuit, in a case arising from Florida, stated that "a court may impose conditions that run with the voiding of the creditor's security interest upon terms that would be equitable and just to the parties in view of all surrounding circumstances." *Williams* v. *Homestake Mortgage Company*, 968 F.2d 1137, 1142 (11th Cir.1992).

rescission by recoupment is never available because the federal remedy itself is inequitable as a "penalty."

Had the Court properly applied federal law in conformity with State rules of procedure, it would have been compelled to answer the certified question in the affirmative for the general proposition presented and order a remand to the trial court to weigh the specific equities of this case, as permitted by § 1635(b). Its holding instead that TILA rescission may never be revived in recoupment, irrespective of the facts or equities of an individual case, exposes the decision simply as condemning federal policy. Accordingly, this matter must be reversed and remanded for further proceedings anchored in the correct rule of federal law.

IV. There Is No Legitimate Policy Basis to Affirm the Florida Supreme Court.

In prior similar cases, lenders and their amici have predicted the near collapse of the mortgage lending industry if consumers are allowed to rescind their loans and keep their homes. They claim that older loans will immediately become vulnerable to late rescission claims and that lenders will have lost a necessary finality to their potential for liability under TILA. They predict billions of dollars of potential losses.

This hyperbole can be discarded. It has been established in some jurisdictions since 1984 that TILA rescission claims may be raised by recoupment. congressional action in 1995 does not make mortgage loans any more vulnerable to rescission because they always were subject to rescission.

If the fears of mortgage lenders were correct — that rescission class actions will flood the courts and the lending industry will face catastrophic losses if the decision below is allowed to stand — then one would expect to have seen these effects in the states where courts have already expressly ruled that rescission by recoupment

is available. (These states are Colorado, Massachusetts, New Jersey, New York, and Illinois). There is no evidence, however, that this has occurred.

Recoupment claims are unsuitable to be raised in a class action since a prior claim against the individual consumer is a prerequisite. Recoupment can only be raised defensively on a case by case basis — preventing the feared flood of claims.

Another reason that rescission by recoupment does not flood the courts is that lenders commit violations supporting rescission in only a very small percentage of their loan originations. Moreover, the right to rescind applies only to non-purchase money mortgages. Nationally, approximately 1% of all mortgages result in foreclosure.[19] The right to rescind by recoupment arises in only an infinitesimal number of these cases.

In addition, creditors retain a right under the TILA to correct disclosure errors at any time in order to avoid liability. 15 U.S.C. § 1640(b). In the unlikely event that a violation will cause a large number of rescission cases, by recoupment or otherwise, the creditor has a simple procedure for correcting the error after the first case is brought, thus removing any possible uncertainty about potential liabilities.

Further, if borrowers pursue rescission defensively after the limitations period has run, the exposure of lenders is strictly limited to the amounts the lender is seeking to collect. In no case would a lender be required to pay even one dollar to a rescinding borrower.

Finally, even if rescission by recoupment were likely to cause serious problems for the mortgage lending industry, this policy argument should be addressed to Congress rather than this Court. However, as discussed above, when the argument was presented to Congress in 1995, Congress evaluated and rejected it.

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[19] National Delinquency Survey, Mortgage Bankers Association of America (June 17, 1996) (data for first quarter of 1996).

CONCLUSION

For all the foregoing reasons, this court should reverse the decision of the Florida Supreme Court.

Respectfully submitted,

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